



Federal Deposit Insurance Corporation

3501 Fairfax Drive, Arlington, VA 22226-3500

Legal Division

February 21, 2012

MEMORANDUM TO: Board of Directors

THROUGH: Michael H. Krimminger
General Counsel

FROM: Floyd I. Robinson
Assistant General Counsel
Professional Liability and Financial Crimes Section

SUBJECT: Professional Liability Program Annual Report for 2011

This is a report by the Professional Liability Unit (“PLU”) of the Legal Division on the results of the FDIC’s professional liability program for 2011. It includes a review of PLU’s workload and staffing at year-end.

The purpose of the professional liability program is to hold accountable directors, officers, and professionals who cause losses to insured financial institutions that later fail and are placed in FDIC receivership. The program’s existence also enhances industry awareness of sound corporate governance standards. On behalf of the FDIC in its receivership capacity, PLU and the Investigations Department of the Division of Resolutions and Receiverships (“DRR”) conduct an investigation of every financial institution failure but only pursue professional liability claims that are both meritorious and expected to be cost-effective. If a meritorious claim exists but is not expected to be cost-effective, PLU refers it to the appropriate primary financial regulator for administrative enforcement action. PLU also assists DRR and the Legal Division’s Financial Crimes Unit to obtain criminal restitution on behalf of the FDIC as receiver from defendants who have been convicted of banking crimes that caused losses to financial institutions that later fail and are placed in FDIC receivership.

Recoveries and Expenses

During 2011 PLU and DRR recovered \$231,927,652 and incurred expenses totaling \$139,464,048 for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Total Recoveries	
Director and Officer (“D&O”) Liability	\$175,087,044	(75.49%)
Accountant Malpractice	\$23,306,618	(10.05%)
Mortgage Malpractice or Fraud (“MMF”)	\$22,392,841	(9.65%)
Fidelity Bond	\$7,746,801	(3.34%)
Attorney Malpractice	\$2,099,576	(0.91%)
Other	\$1,294,772	(0.56%)
TOTAL	\$231,927,652	(100.00%)

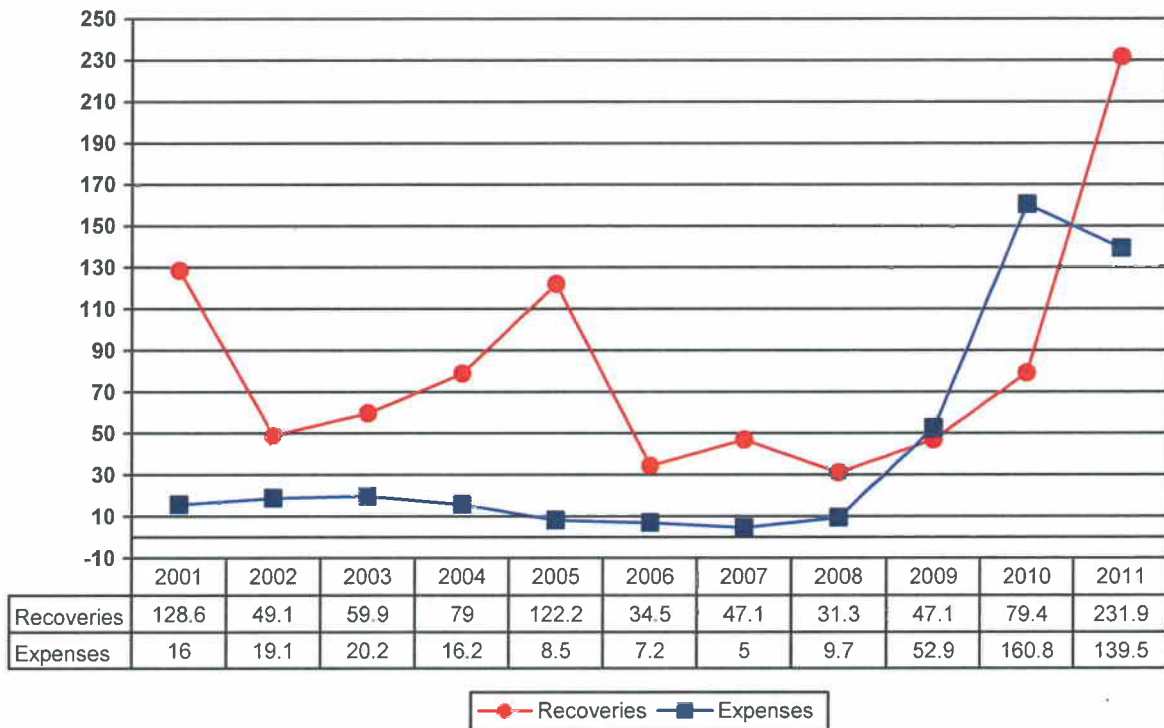
Of the D&O liability recoveries, \$140,547,000 was obtained as a single recovery on June 27 as the final payment in full satisfaction of the remaining balance due to the FDIC from its 2001 settlement with the owners of Coast-to-Coast Financial Corporation, the holding company of Superior Bank, FSB. Superior, of Hinsdale, Illinois, failed on July 27, 2001. On December 10, 2001, the FDIC signed a \$460 million settlement with the owners of Superior and received \$100 million at signing with the remainder due in equal \$24 million annual installments on December 10 of each of the ensuing 15 years. The June 27 payment was an accelerated discounted payment of the remaining \$144 million balance due at the time.

Of the total program expenses of \$139,464,048 incurred during 2011, \$76,632,846 (54.95 percent) was incurred by the Legal Division, \$62,300,468 (44.67 percent) was incurred by DRR, and \$530,734 (0.38 percent) was incurred by other FDIC Divisions and Offices. Legal Division expenses comprise \$64,661,183 paid to outside counsel and consultants and \$11,971,663 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses comprise \$42,057,213 paid to outside contractors and \$20,243,255 for in-house staff. The ratio of total recoveries to total expenses is 1.66 to 1, and the ratio of recoveries to outside counsel and consultant expenses is 3.58 to 1. These ratios are higher than they were for 2010, when the program recovered \$79,426,544, expenses totaled \$160,773,437, the ratio of recoveries to total expenses was 0.49 to 1, and the ratio of recoveries to outside counsel and consultant expenses was 1.68 to 1.

Professional liability program expenses during 2011 are attributable primarily to the substantial receivership funding expenses that the Legal Division and DRR are continuing to incur to conduct investigations and to pursue professional liability litigation arising out of the significant increase in the number of insured financial institutions that have failed since the beginning of 2008. Program recoveries also tend to lag program expenses that are being incurred to obtain the recoveries by several years. Staff typically spends substantial time and money to build a case before defendants become convinced to settle or before staff is able to obtain a judgment. Because only about one in ten individual investigations leads to a recovery, program expenses also include substantial investigation and legal analysis costs that ultimately produce no recoveries whatsoever. Investigation expenses for an individual failed institution include these sunk costs while recoveries from more promising claims from the same institution failure may not be obtained until years later. In addition, program recoveries result not only from settlements reached and judgments obtained in the current reporting period but also from collections from structured settlements reached in previous years. As a result, most of the expenses incurred during 2011 will not yield recoveries until later years. Concomitantly, much of the recoveries

obtained during 2011 actually are the result of expenses incurred in prior years. For all of these reasons, the cost-effectiveness of the program is best measured by comparing recoveries and expenses over many years rather than in any individual year.

FDIC Professional Liability Recoveries and Expenses, 2001-2011 (in \$millions)



As shown in the attached historical table, from 1985 through 2011 the professional liability program has achieved an overall recoveries-to-expense ratio of 3.65 to 1.

Significant Developments During 2011

During 2011 PLU obtained authority from the Board of Directors to file suit against 264 director and officer defendants out of 30 failed institutions for a total of \$5.1 billion in damages. The largest of these was the D&O case out of Washington Mutual Bank (“WaMu”) of Henderson, Nevada, which failed on September 25, 2008, with \$307 billion in assets. After obtaining authority to sue, PLU filed the complaint in this case two days later on March 17, 2011, in the United States District Court for the Western District of Washington against WaMu’s three former principal executive officers for \$917 million in damages based on losses from WaMu’s higher-risk lending strategy. On November 8 the FDIC Board approved a staff-recommended settlement of this case, which as finalized on December 13 calls for the three defendants collectively to provide cash and to turn over pending bankruptcy claims to the FDIC totaling \$64.72 million comprising \$39.575 million from insurance, \$425,000 in cash from personal assets, and the \$24.7 million face value of the defendants’ bankruptcy claims in the Chapter 11 bankruptcy proceeding of WaMu’s former holding company, Washington Mutual, Inc. (“WMI”). When combined with \$125 million that the FDIC expects to receive from a Global Settlement Agreement with WMI and others that, among other things, would release the

FDIC's claims against 12 other former WaMu directors and officers, these WaMu D&O settlements together will result in payments and the turnover of claims totaling \$189.7 million.¹

On May 9 PLU, after obtaining authority to sue from the Board, filed two other lawsuits arising out of WaMu in the United States District Court for the Central District of California asserting both tort and breach of contract claims against two national real estate appraisal companies. *FDIC v. LSI Appraisal, LLC* (C.D. Cal.); *FDIC v. CoreLogic Valuation Services, LLC* (C.D. Cal.) The FDIC's complaints allege that LSI Appraisal, LLC ("LSI") and eAppraiseIT, LLC, n.k.a. CoreLogic Valuation Services, LLC ("CoreLogic"), breached contracts with WaMu by providing 375 grossly negligent appraisals for WaMu residential loans that caused \$258.6 million in losses to WaMu. The complaints further allege that the FDIC's damages are not subject to damage caps in the contracts because the appraisers' conduct was grossly negligent. In November, the district court dismissed the FDIC's tort claims in both cases holding that the economic loss rule bars tort claims arising out of the same facts underlying the FDIC's breach of contract claims. On November 23 and 30, respectively, the FDIC filed amended complaints in both cases asserting only its breach of contract claims but reasserting the same amount of damages against both LSI and CoreLogic.

On June 17 the United States Court of Appeals for the Fourth Circuit affirmed a final judgment of the United States District Court for the Southern District of West Virginia in favor of the FDIC in its accounting malpractice case against Grant Thornton LLP ("Grant Thornton") out of The First National Bank of Keystone. *FDIC v. Grant Thornton LLP* (4th Cir. 2011) (unpublished). Keystone, of Keystone, West Virginia, failed on September 1, 1999. The FDIC tried the case to the court (*i.e.*, without a jury) in 2004. The district court entered a final judgment against Grant Thornton for \$23.7 million with post-judgment interest on March 10, 2010. Grant Thornton appealed, but the Fourth Circuit affirmed the judgment although it did approve Grant Thornton's request for an additional \$540,109 settlement credit resulting in a \$23.2 million final judgment as affirmed on appeal. Subsequently in 2011, Grant Thornton paid the FDIC \$23,306,618 – the \$23.2 million judgment together with accrued pre-judgment interest.

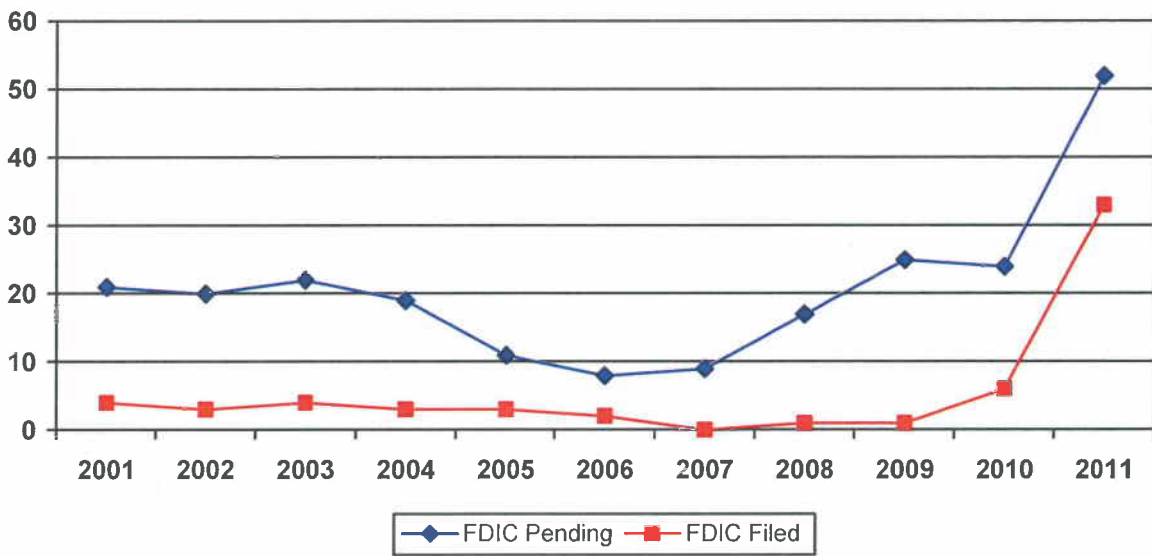
Following approval by the Board of authority to sue, PLU on November 4 filed three lawsuits on behalf of the FDIC as Receiver for Franklin Bank S.S.B. ("Franklin") in state court in Houston, Texas, for \$62 million in damages under state and federal securities laws from the sale of residential mortgage-backed securities ("RMBS") to Franklin. Franklin of Houston, Texas, failed on November 7, 2008. The FDIC filed one lawsuit against Countrywide Financial Corporation; Countrywide Securities Corporation; CWALT, Inc.; CWMBS, Inc.; Bank of America Corporation ("BAC") and its subsidiaries as corporate successors of the Countrywide entities; BNP Paribas Securities Corporation; and Deutsche Bank Securities, Inc., for \$43 million in damages ("Countrywide case"). The FDIC filed the other two lawsuits against Morgan Stanley & Company, Inc., seeking \$9 million and \$10 million in damages, respectively. All three lawsuits are based on misrepresentations made in the RMBS offering documents regarding the quality of the residential loans underlying the RMBS. On December 2 the defendants removed all three cases to the United States District Court for the Southern District of Texas. On

¹ The United States Bankruptcy Court presiding over WMI's bankruptcy proceeding issued an order on February 17, 2012, approving confirmation of WMI's Chapter 11 bankruptcy plan of reorganization and the FDIC's D&O settlements.

December 29 the FDIC moved to remand all three cases to the Houston state court based on the anti-removal section, section 22(a), of the federal Securities Act of 1933. However, staff expects the Judicial Panel on Multi-District Litigation (“MDL”) to transfer one of the cases, the Countrywide case, to the United States District Court for the Central District of California, which is a designated MDL court overseeing multiple cases involving Countrywide RMBS. Once this occurs, staff intends to move the California federal court to remand the case to the Texas state court based on section 22(a).

The following graph shows professional liability civil cases from 2001 through year-end 2011, both filed and pending. (“Pending” actions include claims filed by PLU along with claims filed by an institution before it failed that the FDIC inherited as Receiver.)

FDIC Professional Liability Civil Actions, 2001-2011
(Excludes MMF and other PL-related matters such as individual bankruptcy cases)



PLU also obtained approval during 2011 from delegated authority to file 70 MMF lawsuits. The largest of these arose out of WaMu. The approved defendant in this WaMu case is a title insurance company that issued a closing protection letter (“CPL”) for each of two residential loan closings that subsequently caused \$1.89 million in losses to WaMu. The CPLs require the title company to reimburse WaMu for losses resulting either from the failure of the title company’s closing agent to adhere to WaMu’s closing instructions or from the agent’s fraud or dishonesty in handling WaMu’s funds or documents in closing the loans. These two loan closings were part of a broad conspiracy among the borrowers, the closing agent, and others to defraud WaMu in residential loan closings. PLU is in pre-suit settlement negotiations with the title company defendant. If a settlement cannot be reached, PLU intends to file suit and proceed to trial.

The other 69 MMF lawsuits approved by delegated authority during the year arose out of IndyMac Bank F.S.B. (“IndyMac”) of Pasadena, California, which failed on July 11, 2008 (33); Downey Savings and Loan Association, F.A. (“Downey”), of Newport Beach, California, which

failed on November 21, 2008 (16); AmTrust Bank (“AmTrust”) of Cleveland, Ohio, which failed on December 4, 2009 (10); WaMu (6); BankUnited, FSB, of Coral Gables, Florida, which failed on May 21, 2009 (1); First Federal Bank of North Florida of Palatka, Florida, which failed on April 16, 2010 (1); Franklin (1); and Ravenswood Bank of Chicago, Illinois, which failed on August 6, 2010 (1). These other claims range from \$201,980 for a case arising out of IndyMac to \$1.85 million for another case arising out of WaMu. The approved defendants in these cases are primarily mortgage brokers, qualifying brokers, appraisers, title insurance companies, closing agents, settlement agents, and (to the extent that they personally aided and abetted the mortgage fraud at issue) borrowers. Recovery sources primarily are errors and omission (“E&O”) insurance policies and CPLs.

PLU had 189 active MMF lawsuits at the end of 2011. These arise out of 12 failed institutions but primarily out of IndyMac (93); Downey (34); WaMu (29); AmTrust (12); NetBank of Alpharetta, Georgia, which failed on September 28, 2007 (7); and the First National Bank of Nevada of Reno, Nevada, which failed on July 25, 2008 (7). The remaining 7 MMF lawsuits are associated with 6 other failed institutions around the country. PLU also has more than 2,000 additional residential MMF loss loans in investigation.

PLU staff also obtained approval from delegated authority during 2011 to settle 103 MMF cases. During the year, PLU collected a total of \$22,392,841 from residential MMF claims.

PLU Workload and Staffing at Year-End

During 2011, 92 FDIC-insured financial institutions failed, 51 of which were headquartered in four states, Georgia (23), Florida (13), Illinois (9), and Colorado (6). The largest institution to fail was Superior Bank of Birmingham, Alabama, which failed on April 15, 2011, with \$2.977 billion in assets. These 92 failures brought total institution failures since the beginning of 2007 to 417.

These 417 failures on average also were relatively large in size, since their assets at failure totaled \$671.28 billion. While these 417 failed institutions constitute only 17.81 percent of the total number of 2,341 institutions that failed during the previous failing bank and thrift crisis spanning 13 years from 1982 to 1994, the total assets of \$671.28 billion associated with these 417 failed institutions equals 102.16 percent of the \$657.09 billion in total assets associated with the 2,341 failures from the prior crisis.²

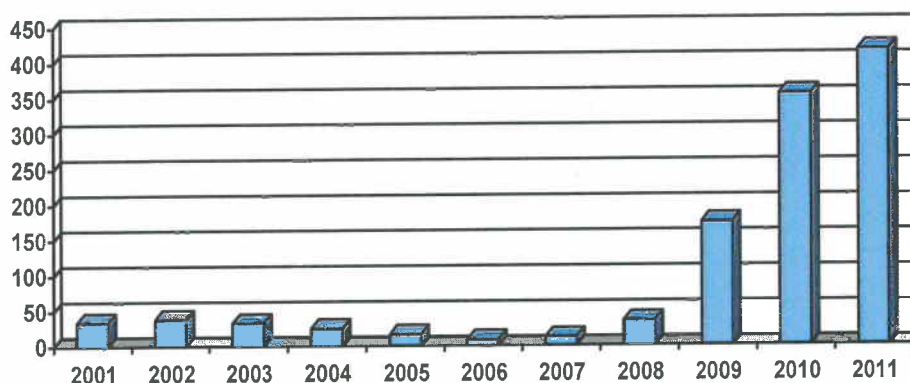
Given their large average size and greater complexity, these 417 failures in the past five years have resulted in a very substantial increase in PLU’s workload. As measured by five workload drivers, PLU’s workload increased 20 percent during 2011 and is expected to continue

² The average asset size of these 417 failed institutions is \$1.61 billion. Even excluding WaMu, which failed in 2008 with \$307 billion in assets, the average asset size of the 416 remaining failed institutions is \$875.67 million – still more than three times the average \$281 million asset size of the 2,341 institutions that failed during the 1982-1994 crisis.

The data in this memorandum on numbers of failed institutions and associated assets have been reviewed and approved by the FDIC’s Division of Insurance and Research.

to increase during 2012. For each institution that fails, PLU opens 11 different types of investigations, although most are soon closed once it becomes clear that no viable claims exist.³ As of September 1, 2007, PLU had 49 open institutions in its inventory (39 of which were open solely for the limited purpose of monitoring collections from judgments and structured settlements), 8 professional liability lawsuits, 3 related lawsuits, 0 MMF lawsuits, 12 open investigations, and 95 active collection matters.⁴ As of year-end 2011, PLU had 417 open institutions, 52 pending professional liability lawsuits, 5 additional related lawsuits, 189 MMF lawsuits, 1,811 open investigations,⁵ and 98 active collection matters.

Institutions With Open Investigations or Lawsuits at Year-end



Institutions open only for collection are not included

To handle its substantially increasing workload, PLU began increasing its staff significantly starting in the second half of 2008. From a single office in Virginia Square that had 13 total staff including managers in mid-2008, PLU as of year-end 2011 had grown to 65 staff including managers in five offices – Virginia Square; the East Coast Temporary Satellite Office (“ECTSO”) in Jacksonville, Florida; the Midwest Temporary Satellite Office (“MWTSO”) in Schaumburg, Illinois; the West Coast Temporary Satellite Office (“WCTSO”) in Irvine, California; and the Dallas Regional Office in Dallas, Texas.⁶

³ The 11 types of investigations are: (1) D&O, (2) fidelity bond, (3) MMF, (4) attorney, (5) accountant, (6) appraiser, (7) RMBS and other securities, (8) commodities, (9) insurance, (10) insurance issuer, and (11) other. Some institutions have multiple matters open. For example, a single bank may have a pending D&O lawsuit, an active RMBS investigation, and a pending attorney malpractice lawsuit.

⁴ For PLU management purposes, a failed institution is “open” in PLU while PLU is working on any matter relating to that failed institution. All institutions in PLU’s inventory are failed institutions.

⁵ An “open investigation” in PLU’s inventory refers to the fact that PLU routinely opens 11 investigations for each failed institution but then “closes” each investigation as it either determines that there is no claim worth pursuing or settles the associated claim. An “open investigation,” therefore, is an investigation in PLU’s inventory that is still active because it has not been settled or otherwise terminated.

⁶ PLU had 48 attorneys on staff at year-end 2011. However, 5 of these were in the process of leaving PLU because of the scheduled sunset of the WCTSO and the expiration of rehired annuitant attorney terms in January 2012 and were carrying either no or very limited workloads that were in the final stages of being reassigned. Accordingly, PLU’s attorney staff is more realistically represented as 43 staff attorneys at year-end 2011.

Conclusion

During 2011 the FDIC's professional liability program operated cost-effectively recovering a total of \$231,927,652 and incurring total expenses of \$139,464,048 as PLU and DRR Investigations continued to devote substantial additional resources to the increasing number of professional liability investigations and litigated cases following the 417 failures that have occurred since the beginning of 2007 through year-end 2011.

cc: All Professional Liability and Financial Crimes Section attorneys

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES (\$ MILLIONS)

	Recoveries ⁷	In-House PLU Expenses	DRR Investigation Expenses	Outside Counsel Expenses	Total Expenses ⁸	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2011	\$231.9	\$12.0	\$62.3	\$64.7	\$139.5	3.58 to 1	1.66 to 1
2010	\$79.4	\$10.1	\$102.5	\$47.2	\$160.8	1.68 to 1	0.49 to 1
2009	\$47.1	\$5.2	\$35.9	\$11.3	\$52.9	4.18 to 1	0.89 to 1
2008	\$31.3	\$2.0	\$5.3	\$2.4	\$9.7	13.1 to 1	3.23 to 1
2007	\$47.1	\$2.0	\$.7	\$2.3	\$5.0	20.62 to 1	9.40 to 1
2006	\$34.5	\$2.6	\$.9	\$3.7	\$7.2	9.30 to 1	4.80 to 1
2005	\$122.2	\$3.4	\$1.1	\$3.9	\$8.5	31.04 to 1	14.38 to 1
2004	\$79.0	\$4.0	\$3.1	\$9.0	\$16.2	8.79 to 1	4.88 to 1
2003	\$59.9	\$3.5	\$3.0	\$13.7	\$20.2	4.38 to 1	2.96 to 1
2002	\$49.1	\$3.2	\$2.8	\$13.1	\$19.1	3.75 to 1	2.57 to 1
2001	\$128.6	\$3.4	\$2.1	\$10.5	\$16.0	12.25 to 1	8.04 to 1
2000	\$54.4	\$4.0	\$2.7	\$14.0	\$20.7	3.89 to 1	2.63 to 1
1999	\$84.2	\$5.8	\$3.2	\$17.4	\$26.4	4.84 to 1	3.19 to 1
1998	\$186.5	\$5.8	\$4.2	\$21.9	\$31.9	8.52 to 1	5.85 to 1
1997	\$156.8	\$7.8	\$2.3	\$29.1	\$39.2	5.39 to 1	4.00 to 1
1996	\$195.9	\$15.8	\$4.0	\$48.1	\$67.9	4.07 to 1	2.89 to 1
1995	\$563.9	\$14.0	\$5.3	\$98.1	\$117.4	5.68 to 1	4.75 to 1
1994	\$909.9	\$17.7	\$11.2	\$135.5	\$164.4	6.72 to 1	5.53 to 1
1993	\$1,231.2	\$18.4	\$17.9	\$187.3	\$223.6	6.57 to 1	5.51 to 1
1992	\$972.6	\$15.7	\$16.6	\$179.3	\$211.6	5.42 to 1	4.60 to 1
1991	\$425.2	\$11.7	\$7.7	\$183.7	\$203.1	2.31 to 1	2.09 to 1
1990	\$374.3	\$6.1	\$5.2	\$94.8	\$106.1	3.95 to 1	3.53 to 1
1989	\$152.1	\$4.5	\$4.5	\$32.0	\$41.0	4.75 to 1	3.71 to 1
1988	\$90.0	\$1.4	\$3.7	\$20.8	\$25.9	4.33 to 1	3.47 to 1
1987	\$71.5	\$1.1	\$4.3	\$15.2	\$20.6	4.70 to 1	3.47 to 1
1986	\$83.3	\$1.0	\$3.0	\$10.9	\$14.9	7.64 to 1	5.59 to 1
TOTAL	\$6,461.90	\$182.20	\$315.50	\$1269.90	\$1769.80	5.09to 1	3.65to 1

⁷ Recoveries comprise all FDIC, RTC, and FSLIC recoveries, including RTC and FDIC Drexel-Milken recoveries of \$1.143 billion.

⁸ Expenses include Drexel-Milken expenses of \$106.1 million. The following categories of expenses are unavailable and are not included: all FSLIC fees and expenses for 1986-1988; FSLIC in-house (legal and investigation) expenses for 1989; and RTC in-house expenses (1989-1995). DRR investigation expenses (in column 4) for all years before 1998 are staff compensation only (and exclude other direct costs). In-house expenses for all years shown exclude overhead